DEPRESSED OIL AND GAS PRICES SIGNAL CAPITAL SPENDING REDUCTIONS FOR 2002

By Nick Snow in New York, Nov 26, 2001 (Petroleum Finance Week/PBI Media via COMTEX) --

Look for major oil companies and independent producers to curtail capital spending next year in response to depressed oil and gas prices. Prospects are good to excellent that many will horde cash for acquisitions instead.

North American natural gas prices have fallen steadily since they peaked near $9 per thousand cubic feet (Mcf) early this year. In its latest short-term energy outlook, the Energy Information Administration blamed a weakening economy, moderate summer weather, ample underground storage and low world oil prices for the decline. While it expects U.S. wellhead prices to average $4.16 per Mcf for 2001, it forecasts continued relatively high inventories and prices averaging $2.20 per Mcf for next year. "Continued steady reductions in drilling, however, are likely to produce conditions favorable to substantial strengthening of natural gas prices going into 2003, especially if the U.S. economy stages a solid economic recovery beginning by mid 2002," EIA said.

Crude oil's price deterioration has been more recent. West Texas Intermediate (WTI), the U.S. benchmark, stayed around $28 per barrel for the first half of the year. It remained above $27 by the end of the summer. But overproduction by members of the Organization of Petroleum Exporting Countries - EIA estimates that it reached 900,000 barrels per day (b/d) in October - combined with rising inventories in consuming nations and a growing worldwide economic slowdown to set the stage for a large oil price decline. The Sept. 11 terrorist attacks aggravated an already fragile situation as product demand plummeted - particularly for jet fuel - and prices plunged toward the low $20 range by early November.

When it met Nov. 14, OPEC decided to protect its market share instead of an oil price. It announced a 1.5 million b/d reduction, but delayed it until Jan. 1 and made it contingent upon non-OPEC producers reducing their production by 500,000 b/d. That commitment was not immediately forthcoming and WTI's price ended the week of Nov. 16 below $18 per barrel.

Several market observers have reduced their 2002 price and spending forecasts even further as a result. Salomon Smith Barney Inc. previously predicted a 20 percent reduction in North American exploration and production outlays next year because it forecast natural gas prices averaging $2.25 per Mcf. But Geoff Kieburtz and Mark Urness, who lead the investment banker's oil field service research in New York, said last week that OPEC apparently has launched an oil price war with producers outside the cartel. They reduced their forecast for international E&P spending growth from 10 to 0 percent (no growth) as a result.

"That's the perennial question..."

Companies customarily keep quiet about their coming year's capital budget deliberations. When a reporter asked Chevron Texaco Corp. (NYSE: CVX) Chairman David J. O'Reilly what impact falling oil prices would have on the newly merged multinational's 2002 outlays last week in New York, O'Reilly responded, "That's the perennial question. Our business is used to volatile swings in prices. We clearly do not base our investment on the price scenarios we've experienced the last two years. Our go-forward range has been $18 to $20 per barrel, with testing of any project at $15." Emphasizing that budget deliberations for 2002 are continuing, he added that the most that can be expected of Chevron Texaco for 2002 is a capital budget roughly equal to Chevron and Texaco's separate 2001 expenditures.

The two companies were among the few majors and large independent producers to reduce outlays this past quarter.

B.P. Plc. (NYSE: BP) had the biggest year-to-year drop, but its figures include acquisitions. If the London multinational is excluded, capital and exploration spending for the 19 other majors (which include refining and marketing) and independents in Petroleum Finance Week's scoreboard climbed year-to-year by 19.6 percent in the third quarter and 35.9 percent in 2001's first nine months.

Several companies stuck to their original budgets. Referring to outlays this past quarter for Exxon Mobil Corp. (NYSE: XOM), Chairman Lee R. Raymond said, "Capital expenditures were 17 percent higher than last year in line with full-year spending plans, and additional operating cost efficiencies were captured in all business lines." Royal Dutch/Shell (NYSE: RD and SC) spent nearly $2.4 billion during the third quarter and produced a 21 percent return on average capital employed (ROACE) over 12 months, up from a 17 percent 12- month ROACE at the end of 2000's third quarter, according to Philip Watts, chairman of the European multinational's committee of managing directors.

Others' higher third quarter and nine-month outlays reflected the impact of acquisitions. But there also was a clear drop in year-to-year growth from the first half in many instances as producers adjusted their output in response to falling oil and gas prices. "While it is prudent to curtail spending and strengthen our balance sheet in the current price climate, our recent discoveries and ongoing development projects, along with the acquisitions we've made at reasonable prices, point to continued production growth in 2002," Apache Corp. (NYSE: APA) President G. Steven Farris said.

"In response to relatively weak natural gas prices and higher service costs over the last few months, we have lowered the pace of U.S. gas development drilling and shifted some of our capital to concentrate on more high-potential exploratory drilling and oil-prone projects," noted Anadarko Petroleum Corp. (NYSE: APC) Chairman Robert J. Allison Jr. "Now is not the time to grow gas production just for the sake of growth. We expect the increased emphasis on exploration to pay off longer-term with additional reserves and higher production."

With commodity prices expected to stay weak through mid-2002 at least, producers are likely to concentrate their reduced expenditures on longer-term projects. They also will keep money available outside their budgets to acquire assets and, in some cases, competitors. Companies traditionally have turned from the drill bit to Wall Street to increase their reserves when oil and gas prices have dropped in response to softened demand. There's no reason to expect them to behave any differently now, particularly since so many have begun to show the kind of balance sheet discipline that capital markets demand.

PETROLEUM FINANCE WEEK'S CAPITAL SPENDING SCOREBOARD

20 Major Oil Companies and Larger Independent Producers' Capital and Exploration Outlays (In Millions of Dollars)

For the Third Quarter...

2001 2000 Change

B.P. (1) $3,363.00 $9,587.00 -64.90%

Exxon Mobil $3,098.00 $2,646.00 17.10%

Royal Dutch/Shell $2,352.00 $2,167.00 8.50%

Chevron $1,180.00 $1,234.00 -4.40%

Texaco $981.00 $1,035.00 -5.20%

Anadarko $739.00 $526.00 40.50%

Amerada Hess $713.00 $205.00 247.80%

Phillips $680.00 $653.00 4.10%

Conoco $784.00 $1,040.00 -24.60%

Kerr-McGee $507.00 $206.00 146.10%

Unocal $437.00 $314.00 39.20%

USX-Marathon $412.00 $353.00 16.70%

Apache $335.40 $211.90 58.30%

Occidental $418.00 $275.00 52.00%

Devon $400.00 $200.00 100.00%

EOG Resources $325.00 $239.00 36.00%

Burlington $246.00 $198.00 24.20%

Ocean Energy $239.00 $162.00 47.50%

Murphy $214.00 $139.40 53.50%

Noble Affiliates $179.30 $106.60 68.20%

Group Total $17,602.70 $21,497.90 -18.10%

...And First Nine Months

2001 2002 Change

B.P. (1) $9,696.00 $15,147.00 -36.00%

Exxon Mobil $8,448.00 $7,294.00 15.80%

Royal Dutch/Shell $7,422.00 $5,280.00 40.60%

Chevron $4,505.00 $3,682.00 22.40%

Texaco $2,757.00 $2,803.00 -1.60%

Anadarko $2,253.00 $977.00 130.60%

Amerada Hess $2,181.00 $610.00 257.50%

Phillips $2,094.00 $1,370.00 52.80%

Conoco $1,755.00 $2,101.00 -16.50%

Kerr-McGee $1,400.00 $441.00 217.50%

Unocal $1,261.00 $872.00 44.60%

USX-Marathon $1,089.00 $1,020.00 6.80%

Apache $1,056.30 $565.30 86.90%

Occidental $965.00 $608.00 58.70%

Devon $900.00 $700.00 28.60%

EOG Resources $804.00 $449.00 79.10%

Burlington $735.00 $617.00 19.10%

Ocean Energy $637.10 $413.30 54.10%

Murphy $629.90 $403.80 56.00%

Noble Affiliates $544.40 $276.90 96.60%

Group Total $51,132.70 $45,630.30 12.10%

Source: Reported financial results and Form 10-Q filings with the Securities

and Exchange Commission. Figures exclude acquisitions, except where noted.

Compans are ranked in order of their 2001 nine-month outlays. (1) Includes

acquisitis.

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